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# TAXATION OF RUSSIAN ‘CONTROLLED FOREIGN COMPANIES’


“knowledge”

***Facts, information and skills acquired through experience or education; the theoretical or practical understanding of a subject.***
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# Taxation of Russian 'Controlled Foreign Companies'

## 1.0 Introduction

On the 18 March 2014, the Russian Ministry of Finance launched the first draft for public discussion of a proposed legislation relating to the residency of companies, the indirect disposal of Russian immovable property and controlled foreign company rules, also referred to as the de-offshorisation of the Russian economy.

The draft law covers three topics:

- Rules relating to the determination of the residency of a Russian company;
- Rules determining when a foreign company is considered as being a Controlled Foreign Company (CFC) and thus considered a Russian-tax resident company for tax purposes; and
- Provisions for the taxing of the indirect disposal of shares in companies whose assets mainly consist of immovable property situated in Russia.

We emphasize that the law is still in draft form and that many of the proposed provisions may change, although the philosophy is clear.

## 2.0 Brief Analysis of Provisions

### (a) Determination of residency of a Russian company

There was talk of such amendments to the Russian tax code for several years now, especially given that latest amendments to the double tax treaties that Russia maintains, including the one with Cyprus, make reference to a 'place of effective management' in determining residency of a company. This concept is at present non-existent in the Russian tax code.

The draft law provides that, in addition to Russian incorporated companies, foreign companies that are effectively managed from Russia, will also be considered as being Russian tax resident and thus subject to tax in Russia under the normal rules. A foreign company would be deemed to be effectively managed in Russia if one of the following conditions are met:

(i) the board meetings are held in Russia;
(ii) the guiding management of the company is performed from Russia; although the term 'guiding management' is not defined at present.
(iii) top-tier management of the company conduct their duties in Russia;
(iv) the book-keeping of the company is performed in Russia; and
(v) the archives of the company are stored in Russia.

### (b) Determination of a controlled foreign company ("CFC")

Where a foreign company is not already treated as a Russian tax resident company based on the effective management test, as explained above, then a foreign company may be treated as a controlled foreign company ("CFC") if all of the following conditions are met:

(i) the company is a tax resident in a country that is included in the new black-list issued by the Ministry of Finance, unless the company is listed on a qualifying stock-exchange; and

(ii) the CFC is controlled by legal or physical persons who are Russian tax-residents. Control is defined as the possibility to influence management decisions on management of assets or distribution of profits. Control is explicitly deemed to arise where a Russian tax resident has a direct or indirect holding of at least 10% in the share capital of the CFC, which is significantly lower than the CFC rules that apply in most other jurisdictions.

Where a foreign company is considered to be a CFC, any undistributed profits will be subject to Russian tax under the normal rules. Where the Russian controlling the CFC is a legal person, this will result in 20% tax on undistributed profits, and 13% if it is a physical person. There does not appear to be any provision at present of offering double tax relief against the Russian tax, for any foreign tax paid.

The current wording of the draft legislation makes it uncertain whether trusts settled in such black-list jurisdictions will be included in the determination of a CFC. It would appear that where the trustees and the beneficiaries are not Russian tax-residents, then the trust would not be considered a CFC, although we are still awaiting for clarifications from the Russian tax authorities on their interpretation.

Russian tax residents are obligated under the provision of the draft legislation, to inform the Russian tax authorities of all CFC's where their participation, either directly or indirectly, in the capital of the CFC, exceeds 1%. There are significant penalties provided for in the draft legislation where the provisions of the law are not adhered to.

### (c) Taxation of indirect disposal of ownership in Russian immovable property

The draft legislation introduces withholding tax provisions on capital gains relating to Russian immovable property. Specifically, where a company, Russian or foreign, has more than 50% of its assets, either directly or indirectly, consisting of Russian immovable property, then any disposal of an interest in such company, either directly or indirectly, should attract a 20% withholding tax in Russia on the resulting capital gain.

There are several questions arising over the above provision, notably how the tax will be withheld in the case that both buyer and seller are foreign companies. In addition, this taxing right would be subject to the relevant provisions contained in effective double-tax treaties, some of which exempt such gains.

## 3.0 Conclusion

The draft legislation introduces important new concepts to the Russian tax code. The philosophy is aggressive against foreign companies that are deemed to be controlled from Russia but do not currently pay tax in Russia. Existing structures should be reviewed to ascertain whether the management and control of a company can be considered as being in Russia, or whether the CFC rules can be triggered. It is important that all companies have substance. It is equally important, where the effective management of the company takes place outside of Russia, that the documentation and communications prove this.

There are many important terms and concepts in the draft legislation that have not been yet clarified. In addition, the draft legislation is likely to change before it reaches its final form, and we are keeping a close eye on this and will keep you informed. In the meantime, we would be happy to discuss how such provisions affect your business and tax structures and what solutions may be available.

***Note:***

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